



NEWGATE
CAPITAL MANAGEMENT LLC

November 2009

FLASH REPORT: EMERGING MARKETS

Portfolio Update

The MSCI Emerging Market Index was up 4.3% in November and 71.7% for the year. All major markets had gains during the month. The macroeconomic backdrop for global equity markets remains essentially unchanged. There is evidence of modest economic recovery in the developed world and stronger growth in developing markets, both supported by significant levels of government intervention. Questions abound regarding the withdrawal of both monetary and fiscal stimulus programs and how the economy, and therefore financial markets, will respond. Equity markets continue to climb the proverbial "wall of worry." At the same time, fears that monetary stimulus (especially in the US) will not be withdrawn in a timely fashion continue to weaken the US dollar and boost commodity prices. Taken together, these facts lead to substantial outperformance for emerging markets.

Despite the strong performance of emerging markets, equities remain fairly valued on average. As in the developed world, third quarter earnings have generally surprised on the upside, though not all companies have reported. Yet stronger earnings and generally healthier economies have kept valuations in line with historical averages. While 2009 has been strong, the markets have rebounded from trough values. Those who call for a correction seem to be forgetting the declines of 2008. Nevertheless, any market that goes up as fast as emerging markets have done inevitably experiences corrections.

As has been the case most of the year, Latin America, powered largely by Brazil's 8.2% gain, had the best performing markets. The rise of Brazilian equities and its currency, the *real*, has been a source of concern for the government. Brazil's significant exports of iron ore and food cause cur-

rency increases. But this same currency appreciation puts Brazilian companies in more competitive markets (such as steel) at a disadvantage. Economists refer to this condition as "Dutch Disease." To stem the *real's* rise, the government instituted a tax on foreign currency transactions. It also included taxing the creation (but not the purchase) of American Depositary Receipts. The market briefly reacted negatively to this news but resumed its rally shortly thereafter. The extent to which these measures are successful remains uncertain. Brazilian exposure in the Newgate Portfolio increased to over 19% due to strong returns but also to additions to the Brazilian food sector. Brazil has become a major exporter of soybeans, beef and chicken to both the developed and developing world, especially China.

Mexican equities rose 10% in November. Mexico exports a significant amount of oil, though unlike Brazil it has not added to reserves. Rising oil prices have helped both countries, as well as Russia. But non-oil exports are rising as well, and Mexican unemployment is declining, now below 6%. These factors are supporting Mexican economic growth and therefore its stock market. The longer term outlook for Mexico remains uncertain. The country must reduce its dependence on oil exports to fund its daily government operations and increase investment. Trend GDP growth is considered to be around 3%, low for an emerging market. As a result, we have maintained only modest positions of approximately 4% in Mexico.

Russian equities rose 2.4% during the month. Buoyed by high oil prices, the market is up almost 100% year to date. Russian foreign currency reserves are once again booming as a result, so

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much so that its central bank announced the intention to diversify its holdings into Canadian dollars. The best performing stocks in Russia have not been oil companies, but rather telecom and materials companies.

China remains our largest holding, approximately 25% of the Portfolio. Chinese equities rose 2.5% in November. All eyes are on China, with concerns about its economy (once the government

begins to withdraw stimulus) and the banking sector's health given the rash of new lending. The Chinese government is constantly being called on to allow its currency to strengthen. None of these issues are new, and none will be resolved in the next few months. We believe that China represents a combination of growth from its rapidly expanding economy, and safety given its large currency reserves. ♦

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